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IN THE

SUPREME COURT OF THE UNITED STATES

70-281

OCTOBER TERM, 1970

No. ~~1826~~

HENRY B. WALLACE and BETTY J. WALLACE,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioners respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in this cause on March 19, 1971, which affirmed a decision of the District Court of the United States for the Southern District of Iowa against Petitioners.

The opinion of the District Court is found in 309 F. Supp. 748 (S.D. Iowa 1970). The opinion of the Court of Appeals has not yet been printed in the Federal Report but appears in 71-1 U.S.T.C. Para. 9281.

GROUNDS ON WHICH THE JURISDICTION OF THE COURT IS INVOKED

The date and time of entry of the judgment sought to be reviewed is March 19, 1971.

Jurisdiction of the Court to review the judgment in question by writ of certiorari is based on 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED FOR REVIEW

The questions presented for review are whether:

1. The Court of Appeals for the Eighth Circuit erred in failing to follow the decision of the Court of Appeals for the Tenth Circuit in *Collins* v. *Commissioner*, 412 F.2d 211 (10th Cir. 1969) and thereby in holding that the transfer of corporate stock from Petitioner Henry B. Wallace to his former spouse incident to divorce constituted a sale or exchange under Sections 1001 and 1002 of the Internal Revenue Code of 1954 where in both the present case and in the *Collins* case (a) the State Divorce Court had the power to order an equitable non-taxable division of property between husband and wife as opposed to a transfer for consideration from the husband to the wife in exchange for the release of her marital rights, (b) the State Divorce Court had the power to award alimony or property in lieu of alimony, (c) much of the corporate stock transferred had been inherited by the husband, (d) the wife did not contribute to the value of the corporate stock by her direct labor or earnings, (e) the property agreement and the

order of the Divorce Court required the transfer of cash and other property in addition to the corporate stock, and (f) in *Collins* the wife released her marital rights in exchange for the aggregate of such cash and other property and corporate stock but in *Wallace* released such rights only in exchange for such cash and other property prior to the ordering by the Divorce Court of the transfer of the corporate stock; and as a consequence of so holding also in holding that dividends on such stock paid during the pendency of divorce proceedings were not properly taxable to the divorced wife as equitable owner of such stock.

2. The decision of this Court in *United States* v *Davis*, 370 U.S. 65 (1962) should be overruled.

STATUTES INVOLVED IN THIS CASE

Internal Revenue Code of 1954, Sections 1001(a) and 1002:

> "Sec. 1001. Determination of Amount of and Recognition of Gain or Loss.
>
> "(a) Computation of Gain or Loss.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized."
>
> "Sec. 1002. Recognition of Gain or Loss.
>
> "Except as otherwise provided in this subtitle, on the sale or exchange of property the entire amount of the gain or loss, determined under section 1001, shall be recognized."

Section 598.14, Code of Iowa, 1962:

"When a divorce is decreed, the court may make such order in relation to the children, property, parties, and the maintenance of the parties as shall be right.

"Subsequent changes may be made by it in these respects when circumstances render them expedient."

12 Oklahoma Statutes 1961, Section 1278:

"When a divorce shall be granted by reason of the fault or aggression of the husband, the wife shall be restored to her maiden name if she so desires, and also to all the property, lands, tenements, hereditaments owned by her before marriage or acquired by her in her own right after such marriage, and not previously disposed of, and shall be allowed such alimony out of the husband's real and personal property as the court shall think reasonable, having due regard to the value of his real and personal estate at the time of said divorce; which alimony may be allowed to her in real or personal property, or both, or by decreeing to her such sum of money, payable either in gross or in installments, as the court may deem just and equitable. As to such property, whether real or personal, as shall have been acquired by the parties jointly during their marriage, whether the title thereto be in either or both of said parties, the court shall make such division between the parties respectively as may appear just and reasonable, by a division of the property in kind, or by setting the same apart to one of the parties, and requiring the other thereof to pay such sum as may be just and proper to effect a fair and just division thereof. In case of a finding by the court, that such divorce should be granted on account of the fault or aggression of the wife, the court may set apart to the husband and for the support of the children, issue of the marriage, such portion of the wife's separate estate as may be proper."

STATEMENT OF THE CASE

On November 9, 1962, Florence K. Wallace initiated divorce proceedings in Polk County, Iowa, District Court against Henry B. Wallace (A. 13)[1]. On the same day the Court issued a restraining order against Henry B. Wallace by which he was restrained during the pendency of the divorce action of disposing of any personal property of Plaintiff or Defendant (Exhibit C, A. 27).

On October 29, 1963, Florence K. Wallace and Henry B. Wallace entered into a "Stipulation of Certain Property Rights" (Exhibit B, A. 22) by which certain property was transferred to Florence K. Wallace which she acknowledged to be "in full and final settlement of all obligations, rights and duties between the parties subject to decree of the Court." The Stipulation made no provision for the settlement of ownership rights to certain shares of stock in certain Pioneer Companies.

On October 30, 1963, the divorce court entered its decree (Exhibit A, A. 17). In this decree the divorce court found that Florence K. Wallace had accepted the property transferred pursuant to Stipulation "in full and final settlement of all claims and demands and in lieu of alimony or for any other provision for her support and maintenance." The Court then decreed Florence K. Wallace "to be the owner of" the Pioneer stock and ordered that dividends paid on said stock held by Henry B. Wallace "for the benefit of" Florence K. Wallace during 1963 were rightfully hers and that therefore she should receive them and report them as her taxable income.

Henry B. Wallace married Petitioner Betty Wallace in November of 1963 and they filed a joint income tax re-

1. References are to Appendix appearing as part of the Certified Transcript of Record in the Court of Appeals for the Eighth Circuit.

turn for the year 1963 (A. 13). On December 29, 1966, a notice of deficiency was issued by the Internal Revenue Service, which on February 16, 1967, was paid by Petitioners who thereafter filed a timely claim for refund and then commenced the present action for a refund of taxes erroneously collected under 28 U.S.C. Section 1346(a)(1). The United States District Court for the Southern District of Iowa entered judgment for the Government and against Petitioners. Petitioners thereafter appealed to the United States Court of Appeals for the Eighth Circuit which affirmed the judgment of the District Court and Petitioners now seek the Writ of Certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit.

REASONS FOR ALLOWANCE OF THE WRIT OF CERTIORARI

1. The Writ of Certiorari should be allowed because the Eighth Circuit Court of Appeals has rendered a decision in conflict with the decision of the Tenth Circuit Court of Appeals on the same matter by failing to follow the decision of *Collins* v. *Commissioner*, 412 F.2d 211 (10th Cir. 1969) which is indistinguishable from the present case.

Alberhaskie v. *Alberhaskie*, 250 Iowa 986, 97 N.W.2d 914.

George F. Collins, Jr., 46 T.C. 461 (1966).

Collins v. *Commissioner*, 412 F.2d 211 (10th Cir. 1969).

Collins v. *Oklahoma Tax Commission*, 446 P.2d 290 (Okla. 1968).

O'Brien v. *O'Brien*, 239 Iowa 1181, 34 N.W.2d 183 (1948).

Nelson on Divorce (2d Ed.), Section 14.120.

2. The Writ of Certiorari should be allowed because this Court should overrule its decision in the case of *United States* v. *Davis*, 370 U.S. 65 (1962), because the *Davis* decision has resulted in discrimination against persons not located in community property states, requires taxpayers to incur the hardship of capital gains tax upon an involuntary transfer when no proceeds have been received upon the transfer with which to pay the taxes, and interferes with the practical and equitable administration of state divorce law and inequitably discriminates against the husband who most generally is responsible for the accruing of family property.

United States v. *Davis*, 370 U.S. 65 (1962).

"Divorce and Taxes: New Aspects of the *Davis* Denouement," 15 U.C.L.A. L. Rev. 176 (1967).

"Property Transfer Pursuant to Divorce—Taxable Event?", 17 Stan. L. Rev. 478 (1965).

19 A.B.A. Tax Section 63-66.

ARGUMENT AMPLIFYING THE REASONS FOR ALLOWANCE OF THE WRIT

1. The Writ of Certiorari Should Be Allowed Because the Eighth Circuit Court of Appeals Has Rendered a Decision in Conflict with the Decision of the Tenth Circuit Court of Appeals on the Same Matter by Failing to Follow the Decision of Collins v. Commissioner, 412 F.2d 211 (10th Cir. 1969) Which Is Indistinguishable from the Present Case.

The Eighth Circuit Court of Appeals has discriminated against Petitioners by imposing the capital gains tax on a transfer of corporate stock indistinguishable from the transfer of corporate stock involved in *Collins* v. *Commissioner*, 412 F.2d 211 (10th Cir. 1969), where the capital gains tax was not imposed. There is, therefore, a conflict

between the decisions of two Circuits and the Writ of Certiorari should be granted under Rule 19(1)(b), Rules of the Supreme Court of the United States.

A. *Both Oklahoma and Iowa law permit an equitable division of property by a court incident to divorce proceedings.* In Nelson on Divorce (2d Ed.), Section 14.120, it is stated:

> "While the general rule is that property jointly acquired by husband and wife cannot be divided between them by a divorce decree, unless authorized by statute, a division of such property is expressly authorized by statute in some states."

Nelson cites the following as jurisdictions in which a division of such property is authorized by statute: Kansas, *Oklahoma*, Minnesota, District of Columbia, Pennsylvania *and Iowa*, quoting for Iowa the statutory language permitting an order in relation to the property of the parties "as shall be right." The Court of Appeals recognized that the Iowa Divorce Court does have power to make an equitable division of property incident to divorce proceedings. See *Alberhaskie* v. *Alberhaskie*, 250 Iowa 986, 97 N.W.2d 914 (1949) and *O'Brien* v. *O'Brien*, 239 Iowa 1181, 34 N.W. 2d 183 (1948).

B. *Both Oklahoma law and Iowa law permit an award of alimony or property in lieu of alimony.* 12 Oklahoma Statutes 1961, Section 1278, specifically provides that in a divorce proceeding the wife "shall be allowed such alimony out of the husband's real and personal property as the Court shall think reasonable * * * which alimony may be allowed to her in real or personal property, or both, or by decreeing to her such sum of money payable either in gross or in installments, as the Court may deem just and equitable."

C. *The rights of the wife in the property of the husband prior to divorce are the same in Iowa and Oklahoma.* The Eighth Circuit Court of Appeals attempted to distinguish the *Collins* case by noting that "the Oklahoma Statute imposed a mandatory rather than permissive duty upon the State Court to effect an equitable division of jointly held property", infra pp. A31-A32. This is erroneous; if property is transferred in order to effect an equitable division of the property, the taxability or non-taxability of the transfer cannot depend upon whether the duty of the Court which ordered the equitable division was a "mandatory duty" or a "permissive duty."

The Court went on to say that under Iowa law the rights of the wife in the husband's property "constituted only a burden on her husband's property rather than being a part owner thereof whereas in Oklahoma the wife is made 'a part owner thereof' by operation of the Statute," infra p. A32. The Eighth Circuit has resorted completely to the use of labels; it has labeled the former Mrs. Collins a "part owner" and has labeled the former Mrs. Wallace a non "part owner" even though it is abundantly clear that in neither Oklahoma nor Iowa does the wife have any right to control or make an inter vivos disposition of the husband's property or any right to make a testamentary disposition of the property. See the discussion of Oklahoma law by the Supreme Court of Oklahoma in *Collins* v. *Oklahoma Tax Commission,* 446 P.2d 290 (Okla. 1968).[2]

2. Because the Eighth Circuit refused to follow the Collins decision of the Tenth Circuit it failed to recognize that dividends with respect to the corporate stock equitably owned by Mrs. Wallace which were paid during the pendency of divorce proceedings were properly taxable to her as ordered by the Divorce Court when ultimately received by her at the time of confirmation of her title to the stock. Petitioners continue to assert the error of the Eighth Circuit in holding that Mrs. Wallace's dividends should be included in the income of Mr. Wallace but Pe-

In other words, the only right of the wife in the property is the right to get it on divorce (or possibly in an action between estranged spouses without divorce) and this right arises because of the general nature of the wife's contribution in marriage, since in both *Collins* and *Wallace* there was no evidence of any specific contribution of the wife to the assets in question by her labor or earnings and the property which was transferred to the wife by the husband had been largely inherited by him alone, *Collins* v. *Oklahoma Tax Commission,* 446 P.2d at 292.

D. *In both Collins and Wallace, the total arrangements made incident to the divorce took account of alimony for the wife as well as an equitable division of property.* The agreement executed by the husband and wife in *Collins* is set forth in *George F. Collins, Jr.,* 46 T.C. 461 (1966). The pertinent provisions of this agreement are as follows:

> "2. The First Party will pay to the Second Party as alimony the sum of $40,000.00 per year for ten years, and thereafter the sum of $35,000.00 per year for ten years and thereafter the sum of $30,000.00 per year during the Second Party's lifetime; provided
>
> * * *
>
> "b) In the event of the remarriage of Second Party, all payments falling due thereafter shall be reduced to fifty per cent (50%) of the amount thereof; and
>
> * * *

titioners do not present this error as a separate reason for the granting of the Writ of Certiorari because the resolution of this issue is dependent upon the resolution of the principal issue, to wit, whether the transfer of the corporate stock was a taxable transfer in exchange for a consideration or was a transfer to effect the confirmation of the equitable title of Mrs. Wallace in said stock.

"3. First Party will transfer and deliver or cause to be transferred and delivered to the Second Party stock certificates evidencing the ownership of record on the books of the company in Second Party of 26,592 shares of the common capital stock of Liberty Glass Company, a corporation; and the First Party warrants * * * that such shares equal 16.62% of the total outstanding common stock of Liberty Glass Company.

* * *

"7. All property, real or personal (other than that herein specifically agreed to be given to First Party) standing or owned of record in the name of Second Party shall belong to Second Party absolutely as her sole, separate and individual property, free, clear and discharged of all claims of First Party.

* * *

"11. Second Party, in consideration of the execution of this Agreement and of the conveyance and payments agreed to be made to her agrees to accept and does hereby accept the same in full, final and complete settlement of all the rights of Second Party of any and every character which she may have or might otherwise have in and to the property of the parties, and in full, final and complete settlement of all claims which she may now have against First Party arising from or incident to the marriage relation, including, but not limited to, claims for division of property, alimony, support or maintenance."

In *Wallace* the agreement executed by the husband and wife provided in pertinent part as follows (A. 22-26):

"1. The plaintiff is to retain as her own property all of the interest of plaintiff in any real estate located in Jasper County, Iowa.

"2. The defendant shall convey to the plaintiff by good and sufficient warranty deed, free and clear of all liens and encumbrances including all regular and

special taxes due and payable in 1963, the real estate locally known as 147 Tonawanda Drive, * * *

"3. The defendant shall pay to the plaintiff in cash the sum of $7,700.74, and in addition the defendant shall pay the Butcher Furnace Company bill of $4,636.29, plus the electrical work of Ace Heating and Electric Company of $309.83.

"4. All of the home furnishings and fixtures shall be the property of the plaintiff except that the defendant shall be entitled to all of his personal effects, the twenty-year electric clock, the Indian drums, the two-wheel trailer, the watch in glass dome received from his father and mother, the antique rocker owned by his great-great grandfather, his personal books, and one of the two silver platters received from the President's Cabinet.

"5. Plaintiff will retain ownership to the 1960 Ford station wagon.

"6. The defendant shall pay all Court costs.

"7. The defendant shall pay the attorney fees for the plaintiff's attorney, Carl A. Smedal, in the amount of $12,500.00.

"8. The defendant shall pay to Carl A. Smedal for the Brown Engineering Company the sum of $125.00 and to Martin, Cloutier & Sanderson the sum of $500.00.

* * *

"12. The parties acknowledge that this Stipulation Agreement does not include any division of property with regard to the stock of either party in Pioneer Hi-Bred Corn Company of Canada, Ltd., Pioneer Hi-Bred Corn Company, Des Moines, Iowa, Pioneer Hi-Bred Corn Company of Illinois, and Pioneer Hi-Bred Corn Company, Inc., Tipton, Indiana. It is the claim of the plaintiff that under the circumstances of

this case, the Court, pursuant to the provisions of Section 598.14 of the 1962 Code of Iowa, should decree the plaintiff to be the owner of certain shares of stock in said companies in addition to those shares of stock already owned by the plaintiff. It is the claim of the defendant that the plaintiff is not entitled to any additional shares of stock in said companies because the stock was not accumulated through the joint efforts of plaintiff and defendant but rather was given to the defendant by his parents. The parties acknowledge that in the event the Court grants a divorce between the parties, the matter of disposition of stock in any of said companies under the law of Iowa and Section 598.14 of the 1962 Code of Iowa is vested in the Court and that the Court may make such order in relation to said property as shall be right.

* * *

"17. Upon compliance by each of the parties with the terms and conditions set out by this Agreement and as specified herein, the obligations and liability of defendant to plaintiff and the plaintiff to defendant shall be wholly and finally completed and shall be in full and final settlement of all obligations, rights and duties betweeen the parties, subject to the decree of the Court."

In *Wallace* the decree of divorce provided in relevant part as follows (A. 17-21):

* * *

"2. It is agreed between the parties to this action that the Stipulation of certain property rights, designated as Exhibit "A", shall be considered by the Court in its findings herein and in the entering of a decree, but that said Stipulation shall not be made a part of the record, except as either party, plaintiff or defendant, may determine to file the same in the future. The parties have entered into a Stipulation of certain property rights designated as Exhibit "A", subject to the approval of this Court, and the Court

finds that the provisions of said Stipulation of Certain Property Rights should be and the same are hereby approved by this Court, except that on the basis of the evidence submitted to the Court and the arguments of counsel and the powers conferred on the Court in the provisions of Section 598.14 of the 1962 Code of Iowa, the Plaintiff should be decreed to be the owner of the following shares of stock in the following respective corporations in addition to the stock in said corporations now standing in the name of the Plaintiff:

Pioneer Hi-Bred Corn Company of Illinois	135 shares
Pioneer Corn Company, Inc. (an Indiana corporation)	48 shares
Pioneer Hi-Bred Corn Company (an Iowa corporation)	255 shares
Pioneer Hi-Bred Corn Company of Canada Limited	500 shares

"In connection with said finding the Court further finds that the Plaintiff is entitled to receive, in addition to the dividends already received by plaintiff during the year 1963, the sum of Ten Thousand One Hundred Sixty-two Dollars ($10,162.00) as dividends paid during the year 1963 on stock in the aforementioned companies, Defendant having been deemed to have received said dividends for the benefit of the Plaintiff during 1963 but that the plaintiff should be required to report said dividends as her income during 1963 for income tax purposes.

"3. The material allegations of the petition of Plaintiff are supported by competent evidence and the Plaintiff is entitled to an absolute decree of divorce but is not entitled to any allowance of alimony nor is she granted any alimony, the Stipulation of Certain Property Rights being a property settlement in full and final settlement and satisfaction of all claims and demands and in lieu of alimony or for any other pro-

vision for her support and maintenance and has fully discharged the Defendant from all such claims and demands except as provided in said Stipulation of Certain Property Rights, and except as this Court has found the Plaintiff to be entitled to under Section 598.14 of the 1962 Code of Iowa.

"IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the bonds of matrimony heretofore existing between the parties hereto should be and the same are hereby severed, dissolved, and held for naught, and that the Plaintiff, Florence K. Wallace be and she is hereby granted an absolute decree of divorce from the Defendant, Henry B. Wallace.

"IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Stipulation of Certain Property Rights be and the same is hereby approved by the Court and that the division of the real and personal property and the property rights therein provided and set out is hereby approved and confirmed and that the Plaintiff not be entitled to any allowance of alimony and that no alimony be granted to the Plaintiff, the Plaintiff having accepted the provisions of the Stipulation of Certain Property Rights in full and final settlement and satisfaction of all claims and demands and in lieu of alimony or for any other provision for her support and maintenance, and IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Defendant is discharged from all such claims and demands except as expressly provided in such Stipulation and except as hereinafter set forth."

It is clear that the *Collins* agreement accomplished two distinct objectives: (a) it provided for payments of cash to the wife as alimony, and (b) it provided for a division of property distinct from these payments of cash. In *Wallace* the Stipulation Agreement and the Divorce Decree accomplished two specific objectives: (a) the Stipulation Agreement provided for the payment of certain amounts of cash and the setting aside or convey-

ance of certain property in lieu of alimony, and (b) the Divorce Decree provided for a division of property distinct from the payments of cash and property in lieu of alimony. There simply is no difference between the facts of the *Wallace* case and the facts of the *Collins* case.

E. *In Wallace, unlike in Collins, the wife specifically released and the divorce court found that she specifically released her marital rights and all other claims in exchange for the other specific cash and property other than the Pioneer stock transferred to her in lieu of alimony whereas the Collins release related to the entire settlement as a whole.* In *Collins* the husband agreed to "transfer and deliver" certain cash and property and the wife agreed to accept cash designated as alimony *and property* "in full, final and complete settlement of all rights of (wife) of any and every character which she may have or might otherwise have in and to the property of the parties, and in full, final and complete settlement of all claims which she may now have against (husband) arising from or incident to the marriage relation including, but not limited to, claims for division of property, alimony, support or maintenance." In spite of the fact that the Oklahoma statute specifically permitted "alimony out of the husband's real and personal property as the court shall think reasonable" and in spite of the fact that by the express language of the Collins agreement the wife released her marital rights in exchange for *all* of the cash *and property* which she received, the Tenth Circuit nevertheless *presumed* that the husband's obligation to convey certain property (the corporate stock) did not relate to these marital rights but instead constituted a non-taxable division of property.

In *Wallace*, unlike *Collins*, there is no need to engage in the presumption that the corporate stock received by

the wife was pursuant to a non-taxable equitable division and the other property was in exchange for marital rights because in *Wallace,* unlike in *Collins,* the specific release by the wife of her marital rights was in exchange only for property *other* than the corporate stock, whereas, in *Collins* the specific release of the wife was in exchange for all cash and property transferred incident to the divorce and the Tenth Circuit presumed this release to relate only to the property and cash other than the corporate stock deemed to be transferred pursuant to a non-taxable equitable division.

The essence of the capital gain under the Internal Revenue Code is the exchange of property for consideration. In *Wallace* the facts were far more favorable to the taxpayer than in *Collins* because in *Wallace* the marital rights of the wife were specifically exchanged for property other than the common stock in the closely held Pioneer corporations. Therefore, if the Tenth Circuit in *Collins* would have held no taxable event under the facts in that case, it surely would have held that there would have been no taxable event under facts akin to *Wallace* where the wife specifically released her rights of support in consideration of property other than the stock in the closely held corporations. There is, therefore, a conflict in the decisions of two Circuit Courts of Appeals and for this reason Petitioners respectfully pray that the Court grant this Petition for the Writ of Certiorari.

2. The Writ of Certiorari Should Be Allowed Because This Court Should Overrule Its Decision in the Case of United States v. Davis, 370 U.S. 65 (1962), Because the Davis Decision Has Resulted in Discrimination Against Persons Not Located in Community Property States, Requires Taxpayers to Incur the Hardship of Capital Gains Tax Upon an Involuntary Transfer When No Proceeds Have been Received Upon the Transfer with Which to Pay the Taxes, Interferes with the Practical and Equitable Administration of State Divorce Law and Inequitably Discriminates Against the Husband Who Most Generally Is Responsible for the Accruing of Family Property.

The decision of the Supreme Court in *United States* v. *Davis*, 370 U.S. 65 (1962) has been widely and justifiably criticized because the application of the decision has resulted in discrimination, hardship and a thwarting of the equitable administration of state divorce laws.

In 1966 the Committee on Domestic Relations Tax Problems of the Tax Section of the American Bar Association formally adopted the following resolution (19 A.B.A. Tax Section 63-66):

> "Resolved, That the American Bar Association recommends to the Congress that the Internal Revenue Code of 1954 be amended to provide that transfers of property in consideration of marriage or agreement to marry or in pursuance of a divorce or property settlement agreement should not give rise to the recognition of income or gain or to a change in the basis of the transferred property;"

The Committeee offered the following explanation:

> "This series of three proposals is designed to accomplish several purposes. First is to overrule United States v. Davis, 370 U.S. 65 (1962), which the committee believes states an undesirable rule of law. The committee believes that neither marriage nor divorce should be a taxable event and that one of the clear-

est examples to prove its point is the imposition under the Davis case of an income tax on the husband when he transfers appreciated property to his wife on divorce. At the same time, the committee believes that a carryover basis from the transferor must be provided for to prevent tax avoidance. * * *

* * *

"The arguments in favor of the propositions are:

"A. Marriage and family formation are not the occasions for the assertion of an income tax. They are socially desirable events upon which our entire society is founded. The tax laws should not operate as a deterrent to them nor seek to profit from them.

"B. A divorce and property settlement are not the occasions from which the public fisc should seek to benefit. To add the burden of an unnecessary tax to the emotional and financial strains implicit in the tragedy of the breakup of a family is greedy and uncivilized. Congress accepted this view when it added Section 2516 to the gift tax provisions.

"C. If a carryover basis is provided, the increment in value above original basis will ultimately be taxed if the property is sold. Since capital gains are subject to a maximum rate of tax, little opportunity for tax avoidance will be opened up.

"D. The gain the Davis case taxed is highly theoretical. The event is one in which a person's wealth is being reduced, not increased. The view that what the husband receives for the property he gives up must be property rights equal to the value of the property he conveys to the wife is one which could prevail only in a tax system in which the taxpayer always has the burden of proof. To state the view as one borne of experience is silly."

In "Property Transfer Pursuant to Divorce—Taxable Event?", 17 Stan. L. Rev. 478 (1965), the author states at 492-93 the following:

"There are several substantial reasons for finding that the transfer is not an appropriate event for taxation. First, in some situations it will be extremely difficult, if not impossible to ascertain the value of the property that the husband has given up. Suppose, for example, that the husband transfers to his wife an interest in a closely held corporation. Or suppose the wife receives an interest in property defeasible upon the occurrence of certain events, such as her remarriage. Ordinarily, the value of such interests can be determined by assuming that the transaction is at arm's length and that the consideration given for them is equal to their value. Here, however, the consideration is not cash or other measurable property, but the wife's inchoate marital rights. These, under the *Davis* approach, are to be measured by equating them with the value of the property given up by the husband. Hence the valuation inquiry is circular. In this situation, determining the husband's gain and the wife's basis in the property will be extremely difficult.

"In the second place, if a tax is imposed, in order to meet his liability the husband may be forced to relinquish certain investments which, but for the tax, he would retain. Divorce is generally an involuntary event; neither party wanted it or planned for it at the outset of the relationship. The decision to seek a divorce is personal and non-economic, and the primary factor is not whether a change in one's investments or a division of his property is timely. While it is true that in an ordinary taxable exchange the taxpayer may be forced out of an investment to pay his tax, this is a factor normally considered in deciding whether to make the change. On the other hand, as a divorce approaches, the element of voluntariness in the decision vanishes, and if the parties do not agree to a property settlement the court will force a property settlement on the husband. Consequently, the property transfer pursuant to divorce takes on the character of an involuntary transfer. Since this is not true

in the ordinary taxable exchange transaction, it may be unduly harsh to force the taxpayer to incur the same substantial tax liability on an involuntary transfer of property, which may have been the result of circumstances entirely beyond his control, as he would incur in an ordinary transaction freely entered into.

"One example of this harsh result is the situation in which the major or sole asset of the husband is ownership of a closely held business corporation. In addition to the valuation problem, the husband, if he is forced to transfer an interest in his business to his wife, may be confronted with a large tax liability and he may have no funds with which to satisfy the obligation. The business is likely to be his sole means of support, and even if willing to sell his share, he will as a practical matter be unable to market an interest in a closely held corporation. Under circumstances such as these, to require the husband to incur a tax liability seems both unfair and unnecessary."

In "Divorce and Taxes: New Aspects of the *Davis* Denouement," 15 U.C.L.A. L. Rev. 176 (1967), the author states at 198-99 as follows:

"Most would agree that divorce or separation, as trying and burdensome as they frequently are, are inappropriate occasions for the imposition of an additional burden in the form of income tax liability by reason of the division of the family's property. However, the foregoing comments demonstrate that, with respect to noncommunity property divisions and perhaps also as to divisions of community property, congressional action is necessary if this policy judgment is to be implemented.

"Insofar as community property is concerned, it may be that legislation similar to that which presently applies to the dissolution of a partnership would be a satisfactory solution. However, any solution to the problem should be uniform, equating the tax burdens

> of married persons wherever domiciled and whatever the ownership pattern regarding their property. One approach that has been suggested, having considerable merit and, in 1966, championed by the Section of Taxation of the American Bar Association, is to amend the Code to provide for nonrecognition of gain or loss by the transferor spouse, and a carry-over of basis to the transferee. * * *"

In addition to the above criticisms that (1) the *Davis* case results in discriminations against taxpayers not located in community property states because of a disparity in tax consequences of divisions of property having identical economic impacts upon the parties involved and (2) results in the hardship of imposing a capital gains tax on an involuntary transaction from which there are no proceeds with which to pay the tax, there should be added the additional criticism that the *Davis* case interferes with the practical and equitable administration of state divorce law because the divisions of property appearing in divorce stipulations and decrees bear no relationship to the actual post-tax results especially since the effective capital gains rates of an individual for any particular year depend upon the level of his other income for that year (see Section 1201, Internal Revenue Code of 1954) and especially since the wife receives not only the property to which she has been deemed entitled by the divorce court but in addition receives the substantial benefit of a stepped-up basis in such property, whereas the husband continues to retain the original basis in identical property retained by him in addition to being forced to pay the taxes necessary to give the wife the benefit of her stepped-up basis.

The practical results of *Davis* further unjustly discriminate against the husband, who most generally is the person responsible for the accumulation of family wealth. It is most common in non-community property jurisdic-

tions to have the court divide property equally between husband and wife. The practical result of such a division is illustrated by *Wallace*, where the net after-tax effect of the property transferred is that the wife ended up with substantially more than half of the property if the decision of *Wallace* is upheld, since Mr. Wallace has to pay a capital gains tax out of his remaining property.

The discrimination is compounded because when Mrs. Wallace sells the stock she will have no capital gains tax to pay except on any further appreciation, whereas Mr. Wallace will have a second capital gains tax to pay on the remaining portion of the stock which was not transferred pursuant to court decree.

Nothing could be more harsh and inequitable than this practical effect of the *Davis* case. The fair and equitable principle would be that where the divorce court seeks to have equal division of the property in a non-community property state, the after-tax effect should be exactly the same as in a community property state. When the stock is ultimately sold or transferred the governement will get its tax. However, until that time the government should not be the third-party beneficiary of the inequitable application of the *Davis* rule in non-community property states.

Respectfully submitted,

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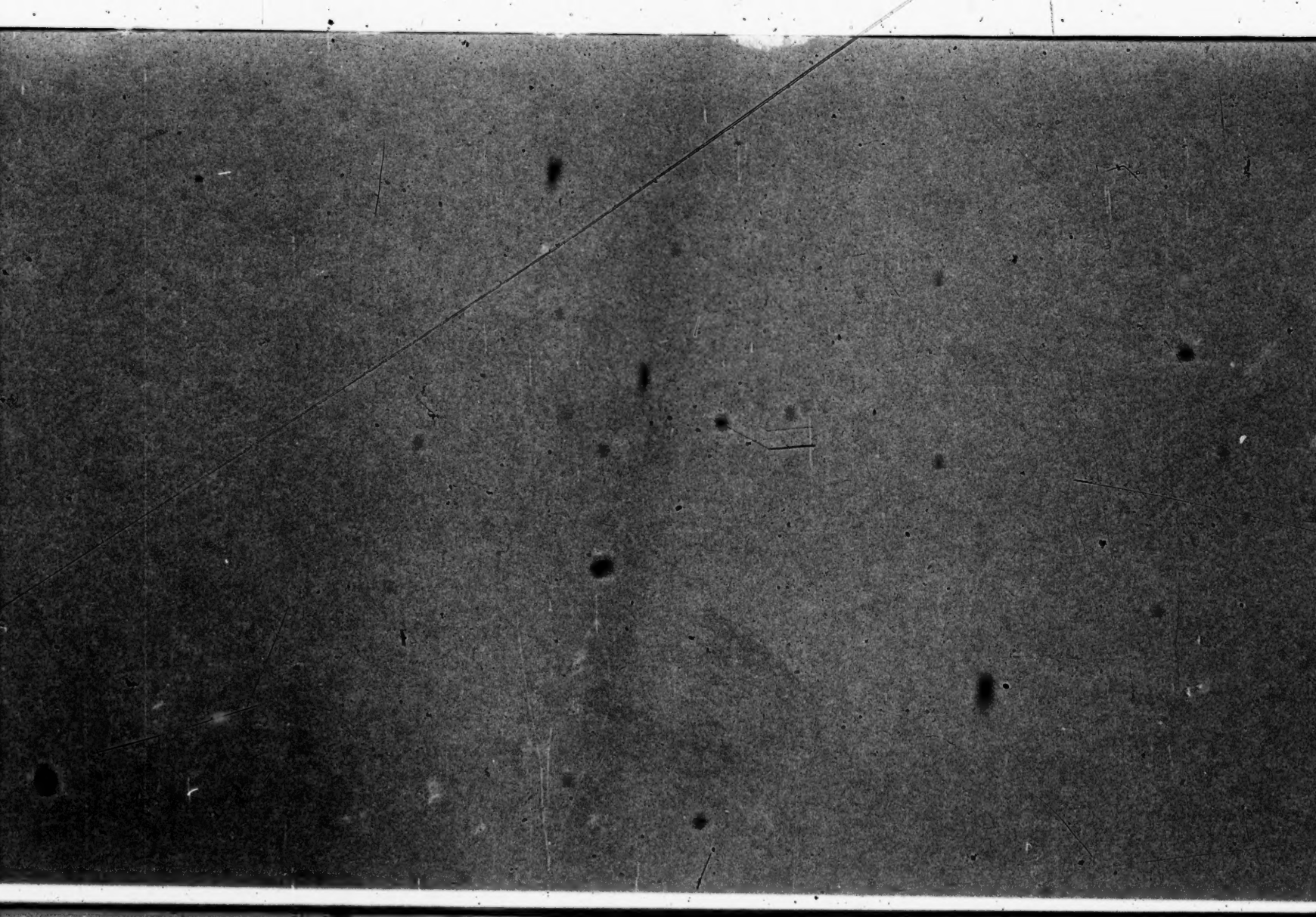

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

(Caption Omitted)

MEMORANDUM AND ORDER

(Filed February 5, 1970)

FINDINGS OF FACT AND
CONCLUSIONS OF LAW

This case came before the Court for trial without a jury. Neither party offered any testimony. The evidence consisted of stipulations of facts and documents, and party-admissions:

JURISDICTIONAL FACTS

1. On March 6, 1964, plaintiffs[1] duly filed their Federal Income tax return for the calendar year 1963 with the District Director of Internal Revenue at Des Moines, Iowa. Plaintiffs at the time of filing this return paid in full the tax shown by the return to be due in the amount of Thirteen Thousand Dollars and Eighty Cents ($13,000.80) (Tr. 12-13).

2. A deficiency for the 1963 taxable year in the amount of $47,250.30 was subsequently assessed and was paid on February 16, 1967, along with interest of $8,032.56, a total of $55,282.86 (Tr. 13).

1. This case involves the income tax consequences to Henry B. Wallace as the result of a divorce suit filed by Florence B. Wallace. A decree of divorce was entered on October 30, 1963. In November, 1963, Mr. Wallace married Betty J. Hampshire and for the 1963 tax year they filed a joint federal income tax return. Mrs. Wallace is a party to this action solely because a joint return was filed. Henry B. Wallace is sometimes referred to herein as plaintiff.

3. Plaintiffs filed a timely claim for refund for the taxable calendar year 1963 on March 31, 1967, with the District Director of Internal Revenue at Des Moines, Iowa (Pltf. Ex. E; Tr. 13).

4. More than six months elapsed between filing the claim for refund and institution of this suit.

5. This Court has jurisdiction pursuant to Title 28, U.S.C. Section 1346(a)(1).

FINDINGS OF FACT

6. Henry B. and Florence Wallace were married on August 11, 1939 in Des Moines, Iowa. In November of 1962 Florence Wallace initiated divorce proceedings in Polk County, Iowa District Court against Henry B. Wallace (Tr. 12). Immediately thereafter the Court entered the following Restraining Order in the divorce action. (Pltf. Ex. C):

> NOW on this 9th day of November, 1962, upon reading the Petition of the Plaintiff in this cause and being advised in the premises the Court finds that the following Order should issue.
>
> IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that during the pendency of this action the Defendant be and he is hereby restrained from disposing of any personal property of the Plaintiff or the Defendant or of the children of the Plaintiff and Defendant except Defendant shall be permitted to expend reasonable amounts from his own funds for the purpose of his own usual and ordinary maintenance.

7. In April, 1963 Florence K. Wallace filed with the Polk County District Court in the divorce action an Application for Order Re Improvement of Family Dwelling (Pltf. Ex. D) alleging that heating facilities were inade-

quate to properly heat the first floor of the house, the heating system having only 57% of the needed capacity at the furnace and the distribution system also being inadequate. Mrs. Wallace claimed she had received medical advice to the effect that a new heating system along with air conditioning and an electro-static type filter were necessary to give some relief to her son who was suffering from asthma.

8. Joel D. Teigland, M.D. has stated in writing (Pltf. Ex. F):

> Henry D. Wallace has been a patient since 1962 with severe asthma, rhinitis and allergic skin rash. Because of the continued asthma symptoms, all efforts have been made to control him with medication and desensitization.
>
> To further avoid exposure, I recommend central air conditioning and electrostatic filter in their home. With the above, his condition is definitely improved.

9. Plaintiffs claim a medical deduction of $3,946.12, a portion of the total cost of $4,946.12 which was expended for a new furnace, duct work, registers, central air-conditioning unit, humidity control unit, electric air filter and the related electric wiring in the home occupied by Henry Wallace's former wife Florence. The break-down of the total cost is as follows:

furnace, runs and registers	$1,991.74
labor on above	450.00
air-conditioning unit	1,182.95
humidity control unit	106.00
electrostatic air filter	555.60
labor on above	350.00
related electrical wiring	309.83
TOTAL	$4,946.12

10. The record contains no evidence with respect to whether or not the fair market value of the home occupied by the former wife of Henry B. Wallace increased as the result of installation of central air-conditioning and an electrostatic filter.

11. On October 29, 1963 Florence K. Wallace and Henry B. Wallace executed a Stipulation of certain property rights which states in pertinent part (Pltf. Ex. B):

> In the event that upon the trial of the above-entitled cause a divorce is granted by the Court dissolving the marriage between the parties hereto, the parties desire to settle all property rights of the parties except as otherwise expressly provided herein and alimony, custody and support payments in connection with and incident to the divorce if the same be granted and subject to the approval and decree of the Court.
>
> NOW, THEREFORE, in consideration of the covenants and agreements hereinafter contained, it is mutually stipulated and agreed by and between the plaintiff and the defendant as follows:
>
> 1. The plaintiff is to retain as her own property all of the interest of plaintiff in any real estate located in Jasper County, Iowa.
>
> 2. The defendant shall convey to the plaintiff by good and sufficient warranty deed, free and clear of all liens and encumbrances including all regular and special taxes due and payable in 1963, the real estate locally known as 147 Tonawanda Drive, Des Moines, Iowa, and legally described as:
>
> Lot One (1) of Gardner Cowles Woods, Plat 2, an official Plat, now included in and forming a part of the City of Des Moines, Iowa, and the North Ten (10) feet of the West One Hundred Forty-one and eight-tenths (141.8) feet of Lot Five (5) of Gardner Cowles Woods, an Official Plat, now included in and forming a part of the City of Des Moines, Iowa, and the South

Two and One-half (2 ½) feet, more or less, of the North Six and One-half (6 ½) feet of Lot Seventy-six (76) paralleling the North line of said Lot Seventy-six (76), of Brown's Subdivision of Lots Eleven (11), Fourteen (14), and Fifteen (15) in Brown's Woods, Section Seven (7), Township Seventy-eight (78) Range Twenty-four (24), all in and now a part of the City of Des Moines, Polk County, Iowa.

3. The defendant shall pay to the plaintiff in cash the sum of $7,700.74, and in addition the defendant shall pay the Butcher Furnace Company bill of $4,636.29, plus the electrical work of Ace Heating and Electric Company of $309.83.

4. All of the home furnishings and fixtures shall be the property of the plaintiff except that the defendant shall be entitled to all of his personal effects, the twenty-year electric clock, the Indian drums, the two-wheel trailer, the watch in glass dome received from his father and mother, the antique rocker owned by his great-great-grandfather, his personal books, and one of the two silver platters received from the President's Cabinet.

5. Plaintiff will retain ownership to the 1960 Ford station wagon.

6. The defendant shall pay all Court costs.

7. The defendant shall pay the attorney fees for the plaintiff's attorney, Carl A. Smedal, in the amount of $12,500.00.

8. The defendant shall pay to Carl A. Smedal for the Brown Engineering Company the sum of $125.00 and to Martin, Cloutier & Sanderson the sum of $500.00.

* * *

10. The plaintiff shall be entitled to no alimony.

* * *

12. The parties acknowledge that this Stipulation Agreement does not include any division of property with regard to the stock of either party in Pioneer Hi-Bred Corn Company of Canada, Ltd., Pioneer Hi-Bred Corn Company, Des Moines, Iowa, Pioneer Hi-Bred Corn Company of Illinois, and Pioneer Hi-Bred Corn Company, Inc., Tipton, Indiana. It is the claim of the plaintiff that under the circumstances of this case, the Court, pursuant to the provisions of Section 598.14 of the 1962 Code of Iowa, should decree the plaintiff to be the owner of certain shares of stock in said companies in addition to these shares of stock already owned by the plaintiff. It is the claim of the defendant that the plaintiff is not entitled to any additional shares of stock in said companies because the stock was not accumulated through the joint efforts of plaintiff and defendant but rather was given to the defendant by his parents. The parties acknowledge that in the event the Court grants a divorce between the parties, the matter of disposition of stock in any of said companies under the law of Iowa and Section 598.14 of the 1962 Code of Iowa is vested in the Court and that the Court may make such order in relation to said property as shall be right.

13. The respective checking and savings accounts of the respective parties shall remain as their own property, and each party shall retain all insurance policies owned by the respective party.

* * *

16. It is mutually agreed by the parties that each of the parties hereto agrees to execute and deliver to the other party any documents that may reasonably be required to accomplish the intention of the instrument and shall do all other things necessary to this end. If either party shall fail to comply with any of the provisions of this Agreement, this particular paragraph of this Agreement shall constitute an actual grant, assignment and conveyance of property and rights in such manner and with such force and ef-

fect as may be necessary to effectuate the terms of this Agreement.

17. Upon compliance by each of the parties with the terms and conditions set out by this Agreement and as specified herein, the obligations and liability of defendant to plaintiff and the plaintiff to defendant shall be wholly and finally completed and shall be in full and final settlement of all obligations, rights and duties betweeen the parties, subject to the decree of the Court.

18. It is agreed that this Stipulation shall be submitted to the Court for approval, but that the same shall not be filed as a part of the Court records at the time of the divorce decree.

* * *

12. On October 30, 1963, the Polk County District Court entered a Decree in the divorce action which stated in part (Pltf. Ex. B):

2. It is agreed between the parties to this action that the Stipulation of certain property rights, designated as Exhibit "A", shall be considered by the Court in its findings herein and in the entering of a decree, but that said Stipulation shall not be made a part of the record, except as either party, plaintiff or defendant may determine to file the same in the future. The parties have entered into a Stipulation of certain property rights designated as Exhibit "A", subject to the approval of this Court, and the Court finds that the provisions of said Stipulation of Certain Property Rights should be and the same are hereby approved by this Court, except that on the basis of the evidence submitted to the Court and the arguments of counsel and the powers conferred on the Court in the provisions of Section 598.14 of the 1962 Code of Iowa, the Plaintiff should be decreed to be the owner of the following shares of stock in the following respective corporations in addition to the stock in said

corporations now standing in the name of the Plaintiff:

Pioneer Hi-Bred Corn Company of Illinois	135 shares
Pioneer Corn Company, Inc. (an Indiana corporation)	48 shares
Pioneer Hi-Bred Corn Company (an Iowa corporation)	255 shares
Pioneer Hi-Bred Corn Company of Canada Limited	500 shares

In connection with said finding the Court further finds that the Plaintiff is entitled to receive in addition to the dividends already received by plaintiff during the year 1963, the sum of Ten Thousand One Hundred Sixty-two Dollars ($10,162.00) as dividends paid during the year 1963 on stock in the aforementioned companies, Defendant having been deemed to have received said dividends for the benefit of the Plaintiff during 1963 but that the plaintiff should be required to report said dividends as her income during 1963 for income tax purposes.

3. The material allegations of the petition of Plaintiff are supported by competent evidence and the Plaintiff is entitled to an absolute decree of divorce but is not entitled to any allowance of alimony nor is she granted any alimony, the Stipulation of Certain Property Rights being a property settlement in full and final settlement and satisfaction of all claims and demands and in lieu of alimony or for any other provision for her support and maintenance and has fully discharged the Defendant from all such claims and demands except as provided in said Stipulation of Certain Property Rights, and except as this Court has found the Plaintiff to be entitled to under Section 598.14 of the 1962 Code of Iowa.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the bonds of matrimony here-

tofore existing between the parties hereto should be and the same are hereby severed, dissolved, and held for naught, and that the Plaintiff, Florence X. Wallace be and she is hereby granted an absolute decree of divorce from the Defendant, Henry B. Wallace.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Stipulation of Certain Property Rights be and the same is hereby approved by the Court and that the division of the real and personal property and the property rights therein provided and set out is hereby approved and confirmed and that the Plaintiff not be entitled to any allowance of alimony and that no alimony be granted to the Plaintiff, the Plaintiff having accepted the provisions of the Stipulation of Certain Property Rights in full and final settlement and satisfaction of all claims and demands and in lieu of alimony or for any other provision for her support and maintenance, and IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Defendant is discharged from all such claims and demands except as expressly provided in such Stipulation and except as hereinafter set forth.

* * *

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that pursuant to the provisions of Section 598.14 of the 1962 Code of Iowa the Court decrees that the Plaintiff shall have as her own property in addition to the shares of stock now standing in the Plaintiff's own name in each of the following four corporations the following additional shares of stock which shall be forthwith transferred on the books of said corporations from the name of the Defendant to the name of the Plaintiff:

Pioneer Hi-Bred Corn Company of Illinois	135 shares
Pioneer Corn Company, Inc. (an Indiana corporation)	48 shares

Pioneer Hi-Bred Corn Company (an Iowa corporation)	255 shares
Pioneer Hi-Bred Corn Company of Canada Limited	500 shares

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Defendant shall pay over to the plaintiff the sum of Ten Thousand One Hundred Sixty-two Dollars ($10,162.00) representing dividends received by the Defendant from stock held in the aforementioned companies by the Defendant for the benefit of the Plaintiff during 1963, provided, however, that the Plaintiff shall report the same as her income for Federal and State income tax purposes received during 1963.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Plaintiff shall have the care, control and custody of the minor children of the parties and that prior to January 1, 1964 the Court shall determine the rights of the Defendant for visitation upon application of the Defendant with notice to Plaintiff.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that all restraining orders and attachments heretofore entered or made herein shall be and the same are dissolved, released and discharged.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Court shall reserve for later hearing the application for the Defendant for creation of trusts for all custodial stock held in the Defendant's name as custodian for any minor child or for the minor children of the parties.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Court retains jurisdiction of the subject matter and of the parties for purposes of the enforcement of the terms of the Stipulation of Certain Property Rights and the terms and provisions of this Decree.

* * *

13. The selling price on November 7, 1963 of the stock transferred pursuant to the divorce decree was $158,486.39 (Def. Ex. 1). The schedules below reflect the total number of shares of stock owned by plaintiff in the four corporations, the dates of acquisition, the transferor of the stock and its basis (Def. Ex. 3):*

Date Purchased or Acquired		Number of Shares	Total Held to Date	Cost	Cost to Date
12-18-36	Rec'd. from Ilo B. Wallace	2	2	143.28	143.28
4-23-37	Stock Subsc.	.8	2.8	80.00	223.28
4-23-38	Stock Subsc. & Issued	1.12	3.92	112.00	335.28
12-21-38	Rec'd. from Ilo B. Wallace	10	13.92	855.30	1,190.58
12-23-46	Rec'd. from Ilo B. Wallace	10	23.92	855.30	2,045.88
12-23-47	Rec'd. from Ilo B. Wallace	5	28.92	427.65	2,473.53
12-14-48	Rec'd. from Ilo B. Wallace	5	33.92	427.65	2,901.18
12-21-48	Rec'd. from Ilo B. Wallace	5	38.92	427.65	3,328.88
12-30-49	Rec'd. from Ilo B. Wallace	2	40.92	171.06	3,499.89
12-9-50	Rec'd. from Ilo B. Wallace	2	42.92	171.06	3,670.95
9-26-51	Stock Issued from Surplus	369	411.2	-0-	3,670.95
12-6-51	Rec'd. from Ilo B. Wallace	30	441.2	248.40	3,919.35
12-19-51	Sold .2 Sh. to James W. Wallace	(.2)	441	(1.78)	3,917.57
12-12-52	Rec'd. from Ilo B. Wallace	10	451	82.80	4,000.37
11-25-53	Rec'd. from Ilo B. Wallace	22	473	182.16	4,182.53
12-3-54	Rec'd. from Ilo B. Wallace	1	474	8.28	4,190.81
12-1-55	Rec'd. from Ilo B. Wallace	1	474	8.28	4,190.81
12-1-55	Rec'd. from Ilo B. Wallace	16	490	132.48	4,323.29
5-16-56	Rec'd. from Ilo B. Wallace	12	502	99.36	4,422.65
4-25-57	Rec'd. from Ilo B. Wallace	12	514.	99.36	4,522.01
4-13-59	Rec'd. from Ilo B. Wallace	10	524	82.80	4,604.81
11-4-63	Rec'd. from Ilo B. Wallace Cost per share to here $8.78	9	533	74.52	4,679.33
11-5-63	Tfr. to Florence D. Wallace	(255)	278	(2,238.90)	2,440.43
11-19-63	Tfr. to Orto & Co.	(278)	-0-	(2,440.43)	-0-

*The name of the company involved in the above listed transactions is Pioneer Hi-Bred Corn Company (an Iowa corporation).

Pioneer Hi-Bred Corn Company of Illinois

Date Purchased or Acquired		Number of Shares	Total Held to Date	Cost	Cost to Date
5-16-38	Purchase	1	1	100.00	100.00
6-16-41	100% Stock Div.	2	3	—	100.00
6-14-46	Rec'd. from Ilo B. Wallace	20	23	1,000.00	1,100.00
12-28-49	Rec'd. from Ilo B. Wallace	4	27	200.00	1,300.00
12-12-50	Rec'd. from Ilo B. Wallace	3	30	150.00	1,450.00
11-3-52	Rec'd. from Ilo B. Wallace	2	32	100.00	1,550.00
12-3-54	Rec'd. from Ilo B. Wallace	3	35	150.00	1,700.00
6-19-56	900% Stock Div.	315	350	-0-	1,700.00
5-12-58	Rec'd. from Ilo B. Wallace	35	385	175.00	1,875.00
5-9-61	Rec'd. from Ilo B. Wallace	28	413	140.00	2,015.00
5-31-60	Rec'd. from Ilo B. Wallace Cost $4.88 per share to here	20	433	100.00	2,115.00
11-7-63	Tfr. to Florence K. Wallace	(135)	298	(658.80)	1,456.20
11-20-63	Tfr. to Orto & Co.	(298)	-0-	(1,456.20)	—

Pioneer Corn Company, Inc. (an Indiana corporation)

Date Purchased or Acquired		Number of Shares	Total Held to Date	Cost	Cost to Date
1-4-38	Purchase ($100.00 Par Value)	.19	.19	19.00	19.00
5-29-41	100% Stock Dividend	.19	.38	-0-	19.00
5-21-46	400% Stock Dividend	1.52	1.90	-0-	19.00
12-18-46	Rec'd. from Ilo B. Wallace	10	11.90	100.00	119.00
3-31-51	Rec'd. from Eastern Co. Merger	1.03	12.93	85.58	204.58
5-17-51	Rec'd. from Dale Porter	.07	13	27.99	232.57
11-3-52	Rec'd. from Ilo B. Wallace	3	16	64.80	297.37
12-6-54	Rec'd. from Ilo B. Wallace	3	19	64.80	362.17
5-2-55	Stock Dividend 5 for 1	95	114	-0-	362.17
5-28-60	Rec'd. from Ilo B. Wallace Cost $3.20 per share to here	4	118	14.40	377.57
11-8-63	Tfr. to Florence K. Wallace	(48)	70	(153.60)	223.97
11-22-63	Tfr. to Orto & Co.	(70)	-0-	(223.97)	-0-

Pioneer Hi-Bred Corn Company of Canada

Date Purchased or Acquired		Number of Shares	Total Held to Date	Cost	Cost to Date
5-9-57	Tfr. fr. Pioneer of Iowa	9.9	9.9	-0-	-0-
8-8-57	From Script Statement	.2	10.1	-0-	-0-
9-4-58	Tfr. to Pioneer of Canada	(10.1)	-0-	-0-	-0-
9-4-58	Rec'd. from Pioneer of Canada	1010	1010	-0-	-0-
7-5-62	Rec'd. from Ilo B. Wallace	250	1260	-0-	-0-
11-8-63	Tfr. to Florence K. Wallace	(500)	760	-0-	-0-
11-21-63	Tfr. to Orto & Co.	(510)	250	-0-	-0-

CONCLUSIONS OF LAW

1. The complaint raises five different issues upon which relief is sought. Two of these, one relating to a dependency exemption and the second relating to the deductibility of accounting fees of plaintiff's former spouse paid by plaintiff pursuant to the divorce decree, have been conceded by plaintiff. This leaves for decision three issues: the medical expense deduction for a portion of the cost of heating and air-conditioning equipment, the taxability to plaintiff of dividends paid to his former spouse pursuant to the divorce decree, and the tax effect to plaintiff resulting from the transfer of stock to his former spouse pursuant to the divorce decree.

Medical Expense Deduction

2. It is clear under Section 213 of the Internal Revenue Code that a deduction is allowed for expenditures made for the medical care of the taxpayer, with certain limitations. It is also clear that even a capital expenditure in the nature of a permanent improvement to real estate can constitute a deductible medical expense if said expenditure is incurred primarily to alleviate an illness, but the deduction is limited to that portion of the expenditure which does not increase the fair market value of the property. Treasury Regulation 1.213-1(e)(iii); *Oliver* v. *Commissioner*, 364 F.2d 575 (C.A. 8th); *Riach* v. *Frank*, 302 F.2d 374 (C.A. 9th); *Gerard* v. *Commissioner*, 37 T.C. 826; *Seymour* v. *Commissioner*, 14 T.C. 111.

3. It is fundamental that the determination of the Commissioner of Internal Revenue is presumptively correct, and the burden is on the taxpayer to show that it is erroneous. *Welch* v. *Helvering*, 290 U.S. 111; *Northern Natural Gas Co.* v. *O'Mally*, 277 F.2d 128 (C.A. 8th). The Commissioner of Internal Revenue has determined that the

plaintiff in the present case was not entitled to the medical deduction of $3,946.12, which he is claiming.

4. With regard to the expenditure of $3,946.12, set forth in Findings of Fact, paragraph 9, the only evidence that the plaintiff has offered with regard to each item listed in that paragraph which indicates that the expenditure was made for medical purposes, is with respect to the air-conditioning unit and the electro-static air filter. This was done by the introduction into evidence of a letter from Dr. Joel D. Tiegland. However, the amount expended on these two items is only $1,744.55. Accordingly, any medical deduction that the plaintiff is entitled to in the present case will be limited to that amount.

5. The plaintiff introduced no evidence at trial as to whether the electro-static air filter nor the air-conditioning unit were permanent improvements. He also introduced no evidence at trial with regard to whether these improvements increased the value of the property to which these were attached. Accordingly, the plaintiff has not met his burden of proof with regard to whether the amount expended on the air-conditioning unit and the electro-static air filter come within the purview of Section 1.213-1(e)(iii). Therefore, no deduction pursuant to Section 213 of the Code can be given to plaintiff for those expenditures.

Dividend Income

6. Pursuant to the divorce decree plaintiff transferred to his former spouse dividends in the amount of $10,162.00 which he received during the year 1963. These dividends had been paid on the stock which the plaintiff owned and was required by the divorce decree to transfer to his former spouse. It is well established that the person who earns income is liable for the tax on it. *Lucas* v. *Earl*, 281 U.S. 111. And the person who owns securities

is liable for the tax on the dividends. *Helvering* v. *Horst*, 311 U.S. 112; *Hyman* v. *Nunan*, 143 F.2d 425 (C.A. 2d). Moreover, when dividends are declared but unpaid at the time that securities are transferred, and are subsequently paid to the transferee, the dividends are taxable to the transferor. *Estate of Smith* v. *Commissioner*, 292 F.2d 478 (C.A. 3d); *Estate of Holmes* v. *Commissioner*, 1 T.C. 508.

7. Plaintiff's contention that the dividends were held in trust must be rejected since there is no evidence that either the stock or the dividends were held in trust. The stock was owned by plaintiff at the time the dividends were paid by the corporations and the dividends were paid to him as the owner of the stock. Consequently, the dividends are taxable to him. The tax liability on income from capital is imposed upon the person who owns the capital. *Doll* v. *Commissioner*, 149 F.2d 239 (C.A. 8th).

8. Plaintiff's contention that he should receive a deduction pursuant to Section 1341 of the Code because it was subsequently discovered that he did not have an unrestricted right to the dividend income must also be rejected. In the present case the plaintiff clearly had an unrestricted right to the income. He used that income in order to satisfy marital claims which his estranged wife had against him.

9. Also, the fact that the divorce court decreed that Florence K. Wallace should pay the income taxes due on the dividends in question is of no consequence in this case. This case deals with the federal income tax law and the power of Congress to tax is not limited by state control. *Doll* v. *Commissioner*, supra. Under the federal tax law the person liable for the income tax on the dividends in question was the taxpayer. *Helvering* v. *Horst*, supra.

The Davis Issue

10. The stock transfer issue is governed by the principles enunciated by the Supreme Court in *United States* v. *Davis*, 370 U.S. 65. In *Davis* the taxpayer and his wife entered into a property settlement and separation agreement which provided for support payments to the wife and a minor child and the transfer of personal property to the wife. The property transferred to the wife was owned by the taxpayer subject to the wife's marital rights under the Delaware law. The husband agreed to transfer to his wife certain stock and the wife agreed to accept the stock in satisfaction of any and all claims and rights against the husband, including dower and all rights under the laws of testacy and intestacy. The agreement was then incorporated into the divorce decree. The question presented to the Supreme Court for decision was whether the difference between the fair market value of the stock at the time of transfer and the basis of the stock constituted taxable income to the husband. This required a two-step analysis—first, whether the transaction was a taxable event; and second, if so, how much taxable gain resulted.

11. For many years prior to the Supreme Court's decision in *Davis*, it was well-established that a property settlement in a common law state constituted a taxable event requiring the realization of capital gains on property transferred by a husband to his former spouse. *Commissioner* v. *Mesta*, 123 F.2d 986 (C.A. 3d) (Pennsylvania); *Commissioner* v. *Halliwell*, 131 F.2d 642 (C.A. 2d) (Connecticut); *Hall* v. *Commissioner*, 9 T.C. 53 (Florida); *Patino* v. *Commissioner*, 13 T.C. 816 (New York); *Estate of Stouffer* v. *Commissioner*, 30 T.C. 1244 (Ohio), reversed on another issue, 279 F.2d 27 (C.A. 6th); *King* v. *Commissioner*, 31 T.C. 108 (Oregon); *Marshman* v. *Commissioner*, 31 T.C. 269 (Ohio), reversed on another issue, 279 F.2d

27 (C.A. 6th). These decisions not only held that the transfer was a taxable event, but also that the amount of the gain was ascertainable since the marital rights released by the wife were equal to the fair market value of the property received on the date of transfer.

12. In *Marshman* v. *Commissioner*, 279 F.2d 27 (C.A. 6th) and in *Davis* v. *United States*, 287 F.2d 168 (Ct. Cl.), the Court of Appeals for the Sixth Circuit and the Court of Claims, respectively, held that the gain realized on the transfer of property was not ascertainable. Neither of these decisions held, however, that the transfer was not a taxable event. It is apparent, therefore, that the primary reason for the granting of certiorari in *Davis* was not to resolve the question of whether the event was taxable, since the courts had uniformly agreed that it was a taxable event, but rather to determine whether the amount of the gain was ascertainable.

13. Despite the uniformity of the decisions to the contrary the taxpayer in *Davis* claimed that the transaction did not result in a taxable event. He argued that the transfer was comparable to a non-taxable division of property between two co-owners and that there should be no distinction between a wife's property rights in a common law jurisdiction vis-a-vis a community property jurisdiction. The Court rejected both these arguments, holding that under Delaware law the wife's inchoate rights do not even remotely reach the dignity of co-ownership since (1) the wife has no interest, active or passive, over the management or disposition of her husband's personal property, (2) her rights are not descendable, (3) she must survive her husband to share in his intestate estate, and (4) upon dissolution of the marriage she shares in the property only to the extent that the court deems "reasonable." Criteria such as the wife's financial condition, her

needs in relation to her accustomed station in life, her age and health, the number of children and their ages, and the earning capacity of the husband must be considered in determining what is "reasonable." After noting the possible logic of taxpayer's argument that the transaction should be considered a non-taxable division of property, the Court held that Delaware law only placed a burden on the husband's property rather than making his wife a part owner, that the wife's rights did not differ significantly from the husband's obligations of support and alimony, and that these obligations were more like a personal liability of the husband than a property interest of the wife. In holding that the transaction constituted a taxable event, the Court relied upon the prior consistent administrative practice and unanimous views of the lower courts.

14. In the case at bar, the parties entered into a stipulation of certain property rights, alimony, custody and support payments "in the event that upon trial of the * * * cause a divorce is granted by the Court dissolving the marriage between the parties * * * and subject to the approval and decree of the Court." The stipulation of property rights left for decision by the Court the question of whether the wife should be awarded shares of stock in certain companies owned by the plaintiff. In entering the divorce decree, the Court, pursuant to the powers conferred by Section 598.14 of the 1962 Code of Iowa held that certain stock having a fair market value of $158,486.39, and having a basis to plaintiff of $3,051.30 should be transferred to the wife.

15. Under Iowa law, plaintiff's former spouse had no interest, active or passive, over the management or disposition of plaintiff's personal property; her rights were not descendable; she must survive her husband to share in his intestate estate; and upon entry of the divorce decree

she may share in the property only to such extent "as shall be right." A property settlement in Iowa is not binding on the Court. Under the provisions of Section 598.14 the Court can alter any property settlement made between the parties. *Messer* v. *Messer,* 238 Iowa 783, 28 N.W.2d 329; *In re Yoss' Estate,* 237 Iowa 1092, 24 N.W.2d 399; and *Knipfer* v. *Knipfer,* 259 Iowa 347, 144 N.W.2d 140. A wife is entitled only to such share of the husband's property as is reasonable under the circumstances. *Jolly* v. *Jolly,* 1 Iowa 9; *Donovan* v. *Donovan,* 231 Iowa 14, 300 N.W. 656. And in requiring the husband to transfer property to the wife, an Iowa court must consider the sex, age, health of the parties, future prospects of each, duration of marriage, indebtedness of each or both, children involved, and other facts helpful in reaching an equitable decision. *Cooper* v. *Cooper,* 259 Iowa 277, 144 N.W.2d 146; *Arnold* v. *Arnold,* 257 Iowa 429, 133 N.W.2d 53; and *Bowman* v. *Bowman,* 259 Iowa 820, 146 N.W.2d 333, 12. Iowa, as Delaware, is a common law jurisdiction, and it is clear that for all relevant purposes the facts of this case are identical to those of *Davis.* The inchoate rights of the wife in her husband's property do not even remotely reach the dignity of co-ownership, but rather partake more of a personal liability of the husband than a property right in the wife. The wife's right to succession and to a reasonable share of the property do not differ significantly from the husband's obligations of support and alimony. Consequently, it is the decision of this Court that the transfer of stock constituted a taxable transfer of property.

16. The Court has carefully considered the plaintiff's argument, for which no precedent has been cited, that *Davis* is distinguishable from the case at bar because the property in *Davis* was transferred pursuant to a stipulation between the parties, while the property in the instant case was transferred pursuant to a divorce decree. This con-

tention is untenable for several reasons. First, the Court in *Davis* stated that its decision turned on whether there was a division of property. In order for there to be a division of property, the Court concluded that the wife's rights in the property had to reach "the dignity of co-ownership." The Court held that the wife's right did not reach "the dignity of co-ownership" and, therefore, there was no division of property. The Court then stated that if there was no division of property there must be a transfer of property. The next question facing the Court was how the transfer was to be categorized. The Court in *Davis* stated explicitly that the transfer could not be considered a gift, and therefore the transfer must be considered a transfer of property in exchange for the wife's marital rights. If the Court in *Davis* concluded that the transfer was not a gift where the parties amicably settled their dispute by a private settlement, the Court in this case certainly cannot conclude that a gift was made where the transfer was made by court decree. Secondly, the Court's decision in *Davis* was based on its examination of the Delaware statute which would have been used to transfer a portion of the husband's property to the wife if the parties had not agreed to a settlement. Therefore, it would be reasonable to assume that if the Court in *Davis* concluded that the fact that the transfer was made by a court was relevant to whether or not the transfer was taxable, it would have discussed this in its opinion since that opinion is based on an examination of a statute under which a Delaware court would make such a transfer. There is no such discussion in the *Davis* opinion. Finally, an adoption of plaintiff's position that the tax effect should be different depending upon whether property is transferred pursuant to a stipulation or pursuant to a court decree would achieve the unconscionable result of penalizing those taxpayers who voluntarily settle their differences. This would discourage stipu-

lations concerning property rights and would proliferate the number of cases in which the divorce court must make the always difficult determinations of property rights. Accordingly, the Court concludes that the argument set forth by the plaintiff with regard to how the property was transferred is irrelevant and that the transfer is taxable pursuant to *Davis*. This holding is supported by the decisions of the only other courts which have considered this argument. *Pullian* v. *Commissioner*, 329 F.2d 97; *Stevens* v. *Commissioner*, 38 T.C. 345; *United States* v. *Zimmers*, decided January 29, 1963 (63-1 U.S.T.C., par. 9269); and *Commissioner* v. *Halliwell*, 131 F.2d 642 (C.A. 2d).

17. Plaintiff places great reliance upon *Collins* v. *Commissioner*, (C.A. 10th), decided June 18, 1969 (1969-2 U.S.T.C. par. 9471). *Collins* holds that under Oklahoma law a transfer of stock from husband to wife pursuant to a stipulation (incorporated into a divorce decree) is not a taxable transfer. In so holding, the Tenth Circuit relied upon the decision of the Supreme Court of Oklahoma in *Collins* v. *Oklahoma State Tax Commission*, 446 P.2d 290, which held that under 12 Okla. Stat. Ann. Section 1278, the wife had an interest in the husband's property which was similar in conception to community property and which may be regarded as held by a species of common ownership. 446 P.2d at 295. This Court believes that *Collins* was incorrectly decided, or at least distinguishable.

18. The issue to be determined in connection with the transfer of stock in a divorce proceeding is whether the transfer constitutes a sale or exchange of the stock within the meaning of Sections 1001 and 1002 of the Internal Revenue Code. It is undisputed that this is a question of federal income tax law. The Supreme Court in *Davis* instructs us that in deciding this federal question we must look to state law to determine whether the wife pos-

sesses meaningful attributes of ownership with respect to the property transferred or whether the wife's rights are merely inchoate. These attributes of ownership are in sum and effect federal criteria. While we must look to state law to determine whether attributes of ownership exist, we must also disregard labels or tags placed upon the wife's rights by the state for non-federal purposes. This is not to say, of course, that the criteria relevant to the *Davis* decision are exclusive or applicable as a mechanical test of tax liability. The issue must always be whether a transfer of property more nearly resembles a division by co-owners or a transfer in exchange for an independent legal obligation. Relevant to this determination is the presence or absence of significant meaningful attributes of ownership arising under state law on the part of the wife. When, as in *Davis*, such attributes are not present or preponderant as a matter of state law, a division of property by co-owners is not a permissible federal result.

19. In *Collins*, the Tenth Circuit relied for federal purposes upon the label "vested" which the Supreme Court of Oklahoma placed upon the nature of the wife's rights under state law for state purposes. Thus, it was concluded for federal income tax purposes that the wife had "vested rights" in the property despite the fact that her rights under the state statute accrued only when the divorce action was filed. The wife need not have exercised the rights. She could not manage or dispose of the property. Her rights were not descendable. She could share in the intestate estate only by surviving her husband. The state divorce court must make such division of the property "as may be just and reasonable." These rights, labeled "vested" by the Oklahoma Supreme Court and the Tenth Circuit, are the same marital rights denominated "inchoate" by the Supreme Court in *Davis*. Accordingly, it seems apparent that the *Collins* court applied an erroneous

standard for federal tax purposes under the *Davis* rationale. It must also be noted that *Collins* stands uniquely alone, among the several courts which have considered the issue, as the only decision in a common law property jurisdiction which holds that a wife has an interest similar to a community property interest in her husband's property and that this interest is a "species of common ownership."

20. Even if one were to assume arguendo that the decision in *Collins* is correct, the present case is distinguishable. The Tenth Circuit in holding that there was not a transfer of property but a division of property relied upon the Oklahoma Supreme Court's decision. The Oklahoma Supreme Court found as a matter of law that in Oklahoma the wife shared in her husband's property upon divorce irrespective of her needs. Therefore, the Supreme Court of Oklahoma found as a matter of state property law that one of the attributes of ownership set forth in *Davis* was present, i.e., that the wife took irrespective of her needs. The Supreme Court of Oklahoma then concluded that the wife's interest in her husband's property was akin to that of a co-owner under state law, and that there was no taxable transfer but rather a division of the property. This is not the law in Iowa.

21. The plaintiff argues that in the present case, unlike *Davis*, there was no taxable exchange of property for marital rights because the wife had surrendered her marital rights by private agreement prior to the divorce decree. The property was transferred pursuant to Section 598.14 of the 1962 Code of Iowa. Any interest which a wife has in her husband's property under this provision of the Iowa law arises out of the marital relationship. Accordingly, any transfer by a court pursuant to this section must be in exchange and in satisfaction of the wife's marital rights. Also, it should be noted that a divorce court in Iowa is not

bound by a private agreement for the settlement of property. It follows that what the wife professed to surrender in a private agreement is of no consequence, since a court makes its own determination with regard to what the parties should receive in a property settlement. Finally, it is worthy of mention that the stipulation of property rights provides for the satisfaction of marital rights according to the "terms and conditions set out by this Agreement and . . . subject to the decree of the Court." One such term is that the Court shall make disposition of the property here in dispute (Pltf. Ex. B). The Court's decree provided for satisfaction of all claims by the Stipulation "except as this Court has found the Plaintiff to be entitled to under Section 598.14 of the 1962 Code of Iowa." (Pltf. Ex. B). Thus, it is far from clear that the state court's disposition of the property was unrelated to the release of marital claims. A contrary inference is at least equally reasonable under the evidence.

22. It is, therefore, the decision of this Court that the transfer by the plaintiff of the stock to his former spouse pursuant to a divorce decree was a taxable event and that the Commissioner of Internal Revenue properly determined that the plaintiff was taxable upon the difference between his basis in the stock and the selling price of the stock on the date of transfer. In arriving at this decision, the Court relies not only upon the decision of the Supreme Court in *Davis* but also upon the unanimous opinions, with the exception only of *Collins* v. *Commissioner*, of all courts which have considered this question.

Judgment will be entered for the defendant at plaintiff's costs.

IT IS ORDERED that the foregoing shall constitute the Findings of Fact, Conclusions of Law and Order for

Judgment in this case. Rule 52(a) of the Federal Rules of Civil Procedure.

Dated:

By the Court:
/s/ William C. Hanson
William C. Hanson
United States District Judge

(Caption Omitted)

JUDGMENT

(Filed February 5, 1970)

Pursuant to Memorandum and Order filed herein, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that judgment is rendered for the defendant and against the plaintiff.

IT IS FURTHER ORDERED that plaintiff will bear the costs of this action.

Dated:

By the Court:
/s/ William C. Hanson
William C. Hanson
United States District Judge

(Caption Omitted)

NOTICE OF APPEAL

(Filed March 23, 1970)

NOTICE IS HEREBY GIVEN that Henry B. Wallace and Betty J. Wallace, Plaintiffs in the above entitled matter, hereby appeal to the United States Court of Appeals

for the Eighth Circuit from the financial judgment entered in this action on the 5th day of February, 1970.

Dated March 23, 1970.

Herrick, Langdon, Belin & Harris
By /s/ David W. Belin
David W. Belin
By /s/ Jeffrey E. Lamson
Jeffrey E. Lamson
300 Home Federal Building
Des Moines, Iowa
288-7071
Attorneys for Plaintiffs

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

(Caption Omitted)

[March 19, 1971.]

Before MATTHES, Chief Judge, LAY and BRIGHT, Circuit Judges.

BRIGHT, Circuit Judge.

Taxpayer Henry B. Wallace[1] brought this action under 28 U.S.C. §1346(a)(1), seeking a refund of $55,282.86 for federal income taxes, and interest thereon, which he alleged were erroneously assessed and collected for the 1963 taxable year. The questions presented to the district court and on this appeal relate to expenditures, payments and

1. Henry B. Wallace's present wife, Betty J. Wallace, is also a party to these proceedings because a joint return was filed for the taxable year in question.

transfers of property made by the taxpayer in connection with divorce proceedings instituted against him by his former wife in an Iowa state court. The federal district court, Judge Hanson, entered judgment for the government, rejecting each of the taxpayer's claims. *Wallace v. United States,* 309 F.Supp. 748 (S.D. Iowa 1970). Taxpayer Wallace prosecutes this appeal, and we affirm.

In November of 1962, appellant's former wife initiated divorce proceedings against him in the district court for Polk County, Iowa, and obtained from the divorce court an order restraining the appellant "from disposing of any personal property" of the appellant, his former wife, or their children, during the pendency of the divorce action. In October of 1963, appellant and his former wife entered into a property settlement agreement, subject to the approval of the divorce court. The agreement generally provided that Wallace's former wife would retain her own real and personal property and obtain title to the "homestead". The agreement further provided that appellant's wife would receive no alimony, and specifically excluded any division of capital stock in certain related Pioneer Hi-Bred Corn Companies (hereinafter Pioneer), leaving disposition of this stock subject to the order of the Iowa state court.

On October 30, 1963, the day following execution of this agreement, the state court entered its divorce decree in which it approved the property settlement and granted custody of the minor children to the plaintiff-wife. The divorce decree also ordered 938 shares of stock in the Pioneer corporations, a portion of the shares previously given to Wallace by his parents, to be transferred to his former wife. The court further ordered the appellant to pay his former wife $10,162, the amount of dividends already received by appellant during 1963 on these shares. The court declared that appellant's former wife should re-

port the dividends as her income for federal tax purposes. The divorce court recognized the property settlement and its own orders for the transfer of stock and dividends as constituting a final settlement of all claims by appellant's former spouse for support and maintenance.

On this appeal, taxpayer Wallace raises the following issues: (1) whether certain expenditures made by Wallace to install a central air conditioning system with an electro-static filter in the family home entitled the taxpayer to a medical expense deduction; (2) whether Wallace realized a taxable long-term capital gain upon the transfer of the stock to his former wife in compliance with the divorce decree; and (3) whether Wallace was liable for income taxes upon dividends paid to him in 1963 with respect to shares of stock which were, subsequent to the receipt of these dividends, transferred to his former wife pursuant to the divorce decree. We consider these questions seriatim.

I. THE MEDICAL EXPENSE DEDUCTION

Taxpayer Wallace spent $4,946 in response to an order of the divorce court to install a new heating-air conditioning system, including humidity controls and air filters, to alleviate his son's asthmatic condition. Appellant subsequently claimed $3,946 of that sum as a medical expense deduction under §213 of the Internal Revenue Code. The government disallowed this claim.

While a capital expenditure of this nature for a permanent improvement to real estate may constitute a deductible medical expense if incurred primarily to alleviate an illness, only that portion of the expenditure which does not increase the fair market value of the property is eligible as a §213 medical expense deduction. Treas. Reg. §1.213-1(e)(iii). See *Oliver* v. *C.I.R.*, 364 F.2d 575, 578

(8th Cir. 1966); *Riach v. Frank*, 302 F.2d 374, 380 (9th Cir. 1962); *Gerard v. Commissioner*, 37 T.C. 826, 829-830. (1962).

In this case, appellant Wallace introduced no evidence with regard to whether these expenditures increased the value of the property to which they were attached and, if so, to what extent. The district court properly noted that a determination by the Commissioner of Internal Revenue is presumptively correct, and the burden is on the taxpayer to show that such a determination is erroneous. *Welch v. Helvering*, 290 U.S. 111 (1933); *Northern Natural Gas Co. v. O'Malley*, 277 F.2d 128 (8th Cir. 1960). We agree with the district court that the taxpayer failed to offer the necessary proof to sustain his entitlement to a medical expense deduction for any part of this expenditure.

II. CAPITAL GAIN ON TRANSFER OF STOCK

As we have already noted, the state court, in its divorce decree; directed the transfer of certain shares of stock from the taxpayer to his former wife. The stock carried a basis for federal tax purposes of $3,051 and a fair market value at the time of transfer of $158,486. The Internal Revenue Service ruled that the transfer constituted a taxable event and assessed taxpayer Wallace for the income tax liability on this capital gain. In contesting this determination by the Internal Revenue Service, the taxpayer contended that (a) the transfer of property incident to the divorce proceedings constituted an equitable division of property between equitable co-owners, rather than transfer of property in exchange for the release of marital obligations; and (b) the order of the divorce court with regard to this stock, entered without any agreement of the parties, constituted a division of property between the parties rather than any "sale or exchange" under §§1001 and 1002 of the Internal Revenue Code of 1954.

The district court rejected the appellant's contentions on this issue, relying upon principles enunciated in *United States* v. *Davis*, 370 U.S. 65 (1962). There, the husband transferred shares of corporate stock to his former wife pursuant to a property settlement agreement executed prior to the entry of the divorce decree. The Supreme Court determined that the transfer constituted a taxable event subjecting the husband to a tax on the appreciated value of the property transferred. As in the instant case, the taxpayer in *Davis* contended that the transfer constituted a non-taxable division of property between co-owners. Justice Clark, speaking for the Court, commented:

> The taxpayer's analogy, however, stumbles on its own premise, for the inchoate rights granted a wife in her husband's property by the Delaware law do not even remotely reach the dignity of co-ownership. The wife has no interest—passive or active—over the management or disposition of her husband's personal property. Her rights are not descendable, and she must survive him to share in his intestate estate. . . .
>
> This is not to say it would be completely illogical to consider the shearing off of the wife's rights in her husband's property as a division of that property, but we believe the contrary to be the more reasonable construction. [370 U.S. at 70]

The transfer of stock in the instant case was effected pursuant to state statutory authorization, IOWA CODE §598.14, which provides:

> When a divorce is decreed, the court may make such order in relation to the children, property, parties, and the maintenance of the parties as shall be right.
>
> Subsequent changes may be made by it in these respects when circumstances render them expedient.

Section 598.14 is liberally construed with considerable discretion being lodged in the trial court to fashion divorce relief. *Call* v. *Call*, 250 Iowa 1175, 98 N.W.2d 335 (1959). A property settlement incident to a divorce action in Iowa is not binding on the court, and under the provisions of §598.14, the court can alter any property settlement made between the parties. *Knipfer* v. *Knipfer*, 259 Iowa 347, 144 N.W.2d 140 (1966); *Messer* v. *Messer*, 238 Iowa 783, 28 N.W.2d 329 (1947). The power given a divorce court in Iowa under §598.14 is very similar to the statutory power involved in *Davis*.[2]

The district court determined that Iowa law, like that of Delaware discussed in *Davis*, granted taxpayer Wallace's former spouse no interest, active or passive, in the latter's personal property prior to the entry of the divorce decree. *Wallace, supra*, 309 F.Supp. at 759. Appellant contends that the circumstances here are distinguishable from those in *Davis*, and relies upon *Collins* v. *Commissioner*, 412 F.2d 211 (10th Cir. 1969), for reversal.

In *Collins*, the court ruled that a transfer of corporate stock by a husband to his wife incident to their divorce proceedings did not constitute a taxable transfer under Oklahoma law. The Oklahoma Supreme Court had previously ruled in related litigation concerning the husband's state income tax liability that the taxpayer's wife possessed a species of common ownership in his property "similar in conception to community property of community property states." *Collins* v. *Oklahoma Tax Commission*, 446 P.2d 290, 295 (Okla. 1968). The Tenth Circuit noted in *Collins* that the Oklahoma statute imposed a

2. The statute, DEL. CODE ANN. 13 §1531(a), provides: "When a divorce shall be decreed for the aggression of the husband, the complainant shall be restored to all her real estate, and allowed, out of her husband's real and personal estate, *such share as the court thinks reasonable* . . . ." (Emphasis added.)

mandatory rather than permissive duty upon the state court to effect an equitable division of jointly held property. The court distinguished the circumstances before it from those presented in *Davis*, concluding that the wife's interest under Delaware law constituted only a burden on her husband's property rather than being a part owner thereof, whereas in Oklahoma the wife is made "a part owner thereof" by operation of the statute. *Collins*, *supra*, 412 F.2d at 212.

We think the district court properly determined that the rights of a wife in Iowa closely parallel those of a wife in Delaware, *i.e.*, she possesses only inchoate rights in her husband's property. *Wallace*, *supra*, 309 F.Supp. at 759. The Supreme Court in *Davis* recognized that the substantive differences between community property and common law systems "may permit different tax treatment among the several States . . . ." 370 U.S. at 71. We agree with the district court that *Collins* v. *Commissioner*, *supra*, 412 F.2d 211, is clearly distinguishable on its facts.

The cases cited by the appellant, *Alberhasky* v. *Alberhasky*, 250 Iowa 986, 97 N.W.2d 914 (1959); *O'Brien* v. *O'Brien*, 239 Iowa 1181, 34 N.W.2d 183 (1948), to the effect that the wife is a co-owner of property in Iowa are inapplicable here, since in each of those cases substantial evidence had been produced which established that the wife had contributed to the assets in question by her labor or earnings. No evidence of this nature has been introduced in the instant case.

Appellant also seeks to distinguish his situation from that of the taxpayer in *Davis* by construing language of the property settlement as providing for the relinquishment of his former wife's marital rights in consideration of her receipt of property other than the stock. Thus, he argues, the divorce decree produced a division of property

rather than a taxable transfer between the husband and wife. The fallacy in this argument lies in its disregard of the decree as the primary factor accomplishing both a transfer of property and a simultaneous extinguishment of marital obligations between the parties to the divorce. We reject any such artificial distinction between this case and *Davis* resting upon subtleties in the mechanics by which a husband divests himself of appreciated property in favor of his wife. Here, as in *Davis*, the absence of any co-ownership interest by the wife in the transferred stock prior to the divorce action requires that this transaction be treated as a taxable event. The district court properly concluded that the rationale of *United States* v. *Davis, supra,* 370 U.S. 65, controls on this issue. See *Harry L. Swaim,* 50 T.C. 302, *aff'd, Swaim* v. *C.I.R.,* 417 F.2d 353 (6th Cir. 1969); *David R. Pulliam,* 39 T.C. 883 (1963), *aff'd, Pulliam* v. *C.I.R.,* 329 F.2d 97 (10th Cir.), *cert. denied,* 379 U.S. 836 (1964); 6 MERTENS, LAW OF FEDERAL INCOME TAXATION §37.48 (1968).

III. THE DIVIDEND INCOME

The Internal Revenue Service determined that dividends paid to taxpayer Wallace during 1963 with respect to the shares of stock subsequently ordered transferred to his former wife constituted taxable dividend income to the appellant for the 1963 taxable year. The district court rejected the taxpayer's theory that he received this income as a trustee for his former wife, concluding that appellant produced "no evidence that either the stock or the dividends were held in trust." 309 F.Supp. at 757. We think the district court clearly and adequately demonstrated that appellant Wallace was properly taxed for this dividend in-

come, and we affirm for the reasons enunciated by the district court on this issue. 309 F.Supp. at 757.

Affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.